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No. 91-706

In the Supreme Court of the United States

OCTOBER TERM, 1991

MESA OPERATING LIMITED PARTNERSHIP, PETITIONER

v.

UNITED STATES DEPARTMENT OF THE INTERIOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals erred in upholding the Department of the Interior's determination that its regulations require petitioner to pay royalties for natural gas produced on federal leases based on the value of the gas placed in marketable condition, and not on the value of raw gas at the time of extraction.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 931 F.2d 318. The report and recommendation of the magistrate (Pet. App. 27a-38a) and the district court's order and judgment adopting that report and recommendation (Pet. App. 21a-25a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on May 15, 1991. A petition for rehearing was denied on June 27, 1991 (Pet. App. 20a). On September 16, 1991, Justice Scalia extended the time for filing a petition for a writ of certiorari to and including October 25, 1991, and the petition was filed on

that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Secretary of the Interior is authorized by the Outer Continental Shelf Lands Act of 1953 (OCSLA), 43 U.S.C. 1331 *et seq.*, to grant leases for the recovery of minerals, including oil and gas, from the seabed of the outer Continental Shelf (OCS). 43 U.S.C. 1337. The Act requires the Secretary "to assure [the] receipt of fair market value for the lands leased and the rights conveyed," 43 U.S.C. 1344(a)(4), and further requires the payment by a lessee to the government of a percentage royalty "in the amount or value of the production saved, removed, or sold." 43 U.S.C. 1337(a)(1)(A). The Minerals Management Service (MMS) administers this program for the Department of the Interior. The Secretary has issued regulations that establish the applicable standard for determining "the value of production" for royalty purposes. These regulations are expressly-incorporated by reference into all leases issued under OCSLA.

Two regulations are particularly important to royalty valuation. In 1954, the Secretary promulgated 30 C.F.R. 250.64 (1955), which granted the Supervisor of the United States Geological Survey (USGS) broad discretion in the determination of production "value" for royalty purposes.[1] The regulation provided, in pertinent part:

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the super-

[1] USGS administered the lease program until that function was transferred to MMS.

> visor, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field or area, to the price received by the lessee, to posted prices, and to other relevant matters. *Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof* or less than the value computed on such reasonable unit value as shall have been determined by the Secretary.

30 C.F.R. 250.64 (1955) (emphasis added).

The Secretary amended the regulation in 1979 to state explicitly: (1) that "[t]he value of production shall never be less than the fair market value"; (2) that "the computation of royalty shall be determined by the Director"; and (3) that the Director "shall consider" the following factors "[i]n establishing the value":

> (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. *Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances* or less than the value computed on the reasonable unit value established by the Secretary.

30 C.F.R. 250.64 (1980) (emphasis added).[2] At all times, the regulations have set the minimum royalty

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[2] The rule was later redesignated as 30 C.F.R. 206.150 (see 48 Fed. Reg. 35,641 (1983)), and was subsequently again modified and redesignated, with prospective effect from

value as the "gross proceeds" received by the lessee—*i.e.*, the total consideration.

A second regulation requires lessees to put the gas into marketable condition and to pay royalty on the value of the gas in marketable condition without deduction for costs of such treatment. This "marketable condition" rule also dates from 1954:

> The lessee shall put in marketable condition, if commercially feasible, all products produced from the leased land *and pay royalty thereon without recourse to the lessor for deductions on account of costs of treatment.*

30 C.F.R. 250.41(b) (1968) (emphasis added), promulgated at 19 Fed. Reg. 2656 (1954).[3] Like the gross proceeds rule, the "marketable condition" requirement was amended but reaffirmed in 1979:

> The lessee shall put into marketable condition, if commercially feasible, all products produced from the leased land. *In calculating the royalty payment, the lessee may not deduct the costs of treatment.*

March 1, 1988 (53 Fed. Reg. 1230 (1988)). The rule retains the "gross proceeds" requirement. 30 C.F.R. 206.152(h) (unprocessed gas), 206.153(h) (processed gas).

[3] The royalty-valuation regulations for offshore lease under OCSLA in fact were patterned on the predecessor onshore royalty program under the Mineral Leasing Act (MLA), 30 U.S.C. 181 *et seq.*, whose regulations have embodied the same "gross proceeds" and "marketable condition" rules since 1942. See 30 C.F.R. 206.103 (1987). See 7 Fed. Reg. 4132 (1942). See also Notice to Lessees and Operators of Federal and Indian Onshore Oil and Gas Leases (NTL-5), 42 Fed. Reg. 22,610, 22,611 (1977) (expressly codifying the rule that "gross proceeds" includes reimbursements for the costs of placing gas in marketable condition).

30 C.F.R. 250.42 (1986) (emphasis added). See 44 Fed. Reg. 61,892 (1979).[4] Under those rules, a lessee's "gross proceeds" for royalty purposes include any reimbursements paid by the gas purchaser to the lessee for putting the products into marketable condition, because costs of putting production into marketable condition are not deductible in calculating royalty.

2. The Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, establishes price ceilings for the sale of defined categories of natural gas. Section 110 of the NGPA provides that the Federal Energy Regulatory Commission (FERC), by rule or order, may allow gas producers to establish first sale prices higher than the ceiling price to recover certain costs associated with putting the gas into marketable condition, including the costs of gathering, compression, and treatment:

> [A] price for the first sale of natural gas shall not be considered to exceed the maximum lawful price * * * if such first sale price exceeds the maximum lawful price to the extent necessary to recover—
>
> (1) State severance taxes * * *; and
>
> (2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the [FERC].

15 U.S.C. 3320(a).

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[4] The 1988 gas royalty valuation regulations, 30 C.F.R. 206.152(i) (unprocessed gas) and 206.153(i) (processed gas), require lessees to place gas "in marketable condition at no cost to the Federal Government or Indian lessor unless otherwise provided in the lease agreement." See note 2, *supra*.

FERC issued Order No. 94 and its progeny to implement this Section of the NGPA.[5] Those orders, codified at 18 C.F.R. Pt. 271 (Subpart K—Allowances for State Severance Taxes and Certain Production-Related Costs), implement the terms of Section 110(a)(1) and (2) to ensure that a first seller of natural gas may receive, within the "first sale price," payment for the stated costs over and above the otherwise applicable ceiling price:

> [T]he price for a first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to that sale, * * * if:
>
> > (1) Such first sale price exceeds the maximum lawful price by an amount necessary to recover a production-related cost * * *;
> >
> > (2) The production-related cost is borne by the seller; and
> >
> > (3) The seller is expressly authorized * * * to be compensated for bearing that production-related cost.

18 C.F.R. 271.1104(a). FERC regulations further define "production-related costs":

> "Production-related costs" means costs, other than production costs, that are incurred:
>
> > (i) To deliver, compress, treat, liquefy, or condition natural gas.

18 C.F.R. 271.1104(c)(7)(i). Under those rules, sellers may charge purchasers and receive reimburse-

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[5] See FERC Order No. 94, 45 Fed. Reg. 53,099 (1980); FERC Order No. 94-A, 48 Fed. Reg. 5152 (1983); FERC Order No. 94-B, 48 Fed. Reg. 5190 (1983), as amended by FERC Order No. 334, 48 Fed. Reg. 44,495 and 52,031 (1983); FERC Order No. 407, 49 Fed. Reg. 49,623 (1984).

ment for those costs, all within the lawful "first sale price."

3. Various gas purchasers challenged the FERC orders implementing Section 110 of the NGPA. The court of appeals resolved those challenges in FERC's favor. *Texas Eastern Transmission Corp. v. FERC*, 769 F.2d 1053 (5th Cir. 1985), cert. denied, 476 U.S. 1114 (1986). As a result, sellers who had sought but not received reimbursements for production-related costs during the pendency of the litigation were entitled to large, lump-sum reimbursements, frequently amounting to several millions of dollars.

In 1987, the MMS Associate Director for Royalty Management issued a policy statement that examined the impact of the *Texas Eastern Transmission* decision on royalties owed the government. Administrative Record (A.R.) I.1. This statement (1) confirmed that reimbursements allowed to lessees after that litigation are part of a lessee's "gross proceeds" and subject to royalty; and (2) reminded lessees that "[a]ny revenues accruing to the seller (lessee) for production-related costs are a part of the value of production and are subject to royalty." A.R. I.1, at 2.

4. Petitioner produces and sells natural gas from offshore federal lands leased from the Department of the Interior under the OCSLA. Those leases contain the standard federal lease provisions that incorporate by reference the Department's regulations. Petitioner's purchasers were among those who withheld NGPA Section 110 reimbursements from payments of the "first sale price" for gas, and subsequently reimbursed those costs to petitioner after the Fifth Circuit's decision in *Texas Eastern Transmission*, which affirmed FERC's Order No. 94 and its progeny. Consistent with its royalty policy MMS issued an audit

letter to petitioner on February 27, 1987, informing petitioner that it was obligated to pay royalties on any reimbursements under those orders and asking petitioner to submit information to assist in MMS's audit of those amounts. See Pet. App. 30a.

Petitioner appealed the directives in the audit letter. On September 29, 1987, the Assistant Secretaries for Land and Minerals Management and Indian Affairs and the Director of the Minerals Management Service issued a decision denying petitioner's appeal. Pet. App. 30a-31a, 39a-42a. They explained:

> It has been the consistent policy of MMS to include in gross proceeds reimbursements received by the lessee for the performance of services such as measuring, gathering, compressing, sweetening, and dehydrating where such services are necessary to place gas in marketable condition. The conclusion that royalty is payable when the lessee is contractually entitled to reimbursement follows from the requirement that the lessee market production and act for the mutual benefit of both itself and the lessor. [citation omitted].

Pet. App. 40a.[6]

Petitioner then brought this suit challenging the Department's decision. A magistrate filed a report and recommended that the government's motion for summary judgment be granted. Pet. App. 26a, 27a-38a. The district court held a hearing and adopted

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[6] Petitioner erroneously states that it argued in its administrative appeal that the MMS royalty demand conflicted with a congressional intent in the NGPA to encourage production of low quality gas, and it complains that the Director's decision did not discuss any such conflict. See Pet. 10, 11. In fact, petitioner's administrative appeal included no such argument. See A.R. II.9.

the magistrate's report and recommendation. *Id.* at 22a-25a. The court recognized that "the rules at issue in this proceeding have been in force and upheld in the administrative and judicial proceedings for decades." *Id.* at 34a-35a. It rejected petitioner's contentions that the Fifth Circuit's decision in *Diamond Shamrock Exploration Corp.* v. *Hodel*, 853 F.2d 1159 (1988), requires payment of royalties on raw gas at the time of extraction, noting that the case "does not address the issues now before the court." Pet. App. 36a. The court also rejected petitioner's contention that the Department's assessment of royalties on treated gas violates the NGPA, holding that "[n]othing in the NGPA or FERC orders purported to change those DOI regulations, or in any way to denounce them," and "[n]othing from this scheme indicates the inconsistency between DOI regulations and FERC regulations." *Id.* at 37a.

5. The court of appeals affirmed. Pet. App. 1a-19a. The court ruled that "the DOI, in affirming the MMS order, made a permissible interpretation of the federal regulations which govern royalties owing from federal natural gas leases." *Id.* at 2a. It concluded that petitioner's reading of the marketable condition rule was "contrary to the interpretation the DOI has given the Marketable Condition Rule for decades, that is, that marketing costs cannot be deducted from the *gross proceeds*, equal to the value of production, before royalty is calculated." *Id.* at 14a. The court further explained that "any anomaly which results from allowing higher royalty on lower quality gas by assessing royalty on § 110 payments is a consequence of the NGPA/FERC price regulation system and not of the scheme setting out the royalty owner's rights." *Id.* at 15a.

In addition, the court found no conflict between application of this rule and either the NGPA or FERC policy. Pet. App. 16a-17a. The court explained that Congress could have, but did not, "provide that NGPA § 110 payments not be subject to royalty," *id.* at 16a, and that FERC has "nowhere indicated" that its "nomenclature affects or refers to royalty valuation," *id.* at 17a. Finally, the court of appeals rejected petitioner's reliance on the court's prior decision in *Diamond Shamrock Exploration Corp.* v. *Hodel*, 853 F.2d 1159 (5th Cir. 1988). The court explained that *Diamond Shamrock* held simply that the government is not entitled to a royalty until there was physical severance of gas, but did not alter the established rule that royalty valuation is based on gross proceeds from the sale, without deduction for the producer's costs in making the gas marketable. Pet. App. 18a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with the decisions of this Court or any other court of appeals. Accordingly, further review it not warranted.

1. Petitioner contends that the court of appeals erred by according undue deference "to the decision of one federal agency when the agency decision necessarily limits and interprets a statute administered by, and regulations and decisions issued by, a second federal agency." Pet. 14. According to petitioner, further review is appropriate because "it is beyond doubt that the DOI decision 'trenches on' the jurisdiction of the FERC," and "the DOI's organic statute, OCSLA, clearly requires the agency to consult with and co-

ordinate administration of the offshore leasing program with other agencies." Pet. 15-16.

Petitioner posits a conflict between federal agencies that simply does not exist. The OCSLA, on the one hand, entrusts the Secretary of the Interior with responsibility for collecting royalties under federal offshore leases. The Secretary determines the proper royalty payments to the government under the OCSLA. The NGPA, on the other hand, entrusts FERC with responsibility for administering market-wide natural gas price regulations. As the court of appeals correctly recognized, FERC has no jurisdiction over the royalty obligations of lessees to the federal government:

> Generally speaking, as with the NGPA, Order 94 is directed to the producer-purchaser relationship and does not address allocation of payments under the lease between the DOI-lessor and the producer-lessee, which is governed by regulations originally enacted some 27 years earlier.

Pet. App. 17a n.57. Indeed, petitioner itself agrees that "Mesa's royalty obligation is governed by the OCSLA, the leases and [the] DOI regulations." Pet. 3.[7]

Petitioner mistakenly asserts that "DOI has treated as part of the price of gas costs that are defined by Section 110 of the NGPA as not part of the price of gas." Pet. 15. That assertion misapprehends the

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[7] The courts have held that FERC similarly does not have authority over royalty provisions in nonfederal leases. See *Flowers* v. *Diamond Shamrock Corp.*, 693 F.2d 1146, 1153-1154 (5th Cir. 1982); *Sowell* v. *Natural Gas Pipeline Co. of America*, 604 F. Supp. 371, 374 (N.D. Tex. 1985), aff'd, 789 F.2d 1151 (5th Cir. 1986).

meaning of Section 110.[8] In any event, neither Section 110 nor any other provision of the NGPA requires the Department of the Interior to revise the way in which the government determines a lessee's royalty obligations. Congress enacted the NGPA to address the price disparities that had developed under the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, with respect to interstate and intrastate sales prices for natural gas. The NGPA does not mention either the OCSLA or the royalty valuation regulations, and it does not purport to extend FERC's jurisdiction to encompass the payment of royalties. In short, the NGPA exhibits no intent to equate royalty value with the value of raw gas, and petitioner does not, and cannot, identify any statutory provision or legislative history that would indicate that Congress intended such an effect.

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[8] Section 110 provides that a lessee-seller may recover gas treatment costs (among others) from purchasers, and the total amount paid—including such reimbursements—is part of the "price for the first sale of natural gas":

> [A] price for the first sale of natural gas shall not be considered to exceed the maximum lawful price * * * if such first sale price exceeds the maximum lawful price to the extent necessary to recover—
>
> * * * * *
>
> > (2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the [FERC].

15 U.S.C. 3320(a). Under the terms of the provision, that "first sale price" shall not be considered to exceed the "maximum lawful price" to the extent that price is exceeded due to reimbursements for the specified kinds of costs. Thus, contrary to petitioner's assertion (Pet. 15), the provision makes clear that such reimbursements are, in fact, *part of* the "price for the first sale of natural gas."

Petitioner contends that "because DOI has required Mesa to pay the 16 2/3 per cent royalty on those [reimbursement] costs, it has denied Mesa the 100 per cent reimbursement of those costs that Section 110, as implemented by FERC's Order 94 regulations, was supposed to assure, pursuant to Congress's desire to avoid the disincentive to produce low-quality gas in a price-controlled environment." Pet. 15. Petitioner simply assumes that because Congress allowed producers reimbursement for treatment costs, it also intended to exempt producers from paying royalties on the cost-reimbursement portion of their gross proceeds. Nothing in Section 110 of the NGPA or the implementing FERC orders indicates such an intent. Thus, Section 110 should not be read to alter the Interior Department's longstanding regulations, which provide that producers must pay royalties on *all* gross proceeds from their sales. See Pet. App. 15a.

There is no merit to petitioner's repeated assertions that the Department's decision "trenches on" FERC's jurisdiction by conflicting with Congress's supposed "desire" in the NGPA "to avoid the disincentive to produce low-quality gas in a price-controlled environment." Pet. 15. See also Pet. 10, 11, 19. First, neither the text nor the legislative history of Section 110 demonstrates that the overriding "desire" of Congress in enacting that Section was "to avoid the disincentive to produce low-quality gas in a price-controlled environment."[9] Pet. 15. Although the

[9] In fact, the Conference Report on the NGPA states that Congress permitted "the authority * * * for making adjustments to all ceiling prices" simply as a continuation of the prior practice under the Natural Gas Act of permitting an "allowance for production related costs." H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. 67, 91 (1978).

Fifth Circuit recognized in *Texas Eastern Transmission Corp.* v. *FERC*, 769 F.2d at 1064, that one of the effects of this provision may be the production of lower-quality gas, petitioner's heavy reliance on this effect as the driving force behind inclusion of the provision has no support in the NGPA or its history.

Moreover, even assuming that Congress enacted Section 110 of the NGPA to encourage the development of low quality gas, petitioner is mistaken in suggesting that exempting cost reimbursements from the base on which royalties are calculated is necessary to achieve that policy. If petitioner or any lessee believes that complete exploitation of the resources in a lease area is uneconomic due to royalty considerations, the OCSLA itself provides an avenue for relief. The statute provides that the Secretary "may, in order to promote increased production on the lease area, * * * reduce or eliminate any royalty or net profit share set forth in the lease for such area." 43 U.S.C. 1337 (a)(3).[10] Pursuant to that provision, the Secretary has promulgated a regulation that permits a lessee to petition for such relief. See 30 C.F.R. 203.50. Thus, the OCSLA itself incorporates a method for accommodating petitioner's concerns. There is simply

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[10] The Committee report explains this provision as follows:

> It might become uneconomic during later phases of production to exploit resources because of [statutory minimum royalties and net profit shares]. Therefore, in paragraph (3) of the subsection, the Secretary is given the authority, after production has commenced, to reduce or eliminate any royalty of [*sic*] net profit shares so as to encourage complete exploitation of the resources in a lease area.

H.R. Rep. No. 590, 95th Cong., 1st Sess. 136 (1977).

no need for the Secretary to alter his decades-old method for determining royalty value under OCSLA.

Petitioner asserts that "the DOI's organic statute, OCSLA, clearly requires the agency to consult with and coordinate administration of the offshore leasing program with other agencies." Pet. 15-16. But petitioner cites no provision in the OCSLA or the NGPA that requires the Secretary to coordinate royalty valuation in Section 8 of the OCSLA with any other agency, and there is none. Petitioner relies (Pet. 9, 19-20 & n.38) on a portion of the legislative history of the 1978 amendments to the OCSLA to support its claim that Congress intended to require such consultation. But petitioner's quotations relate to Section 18 of the OCSLA, which requires the Secretary periodically to prepare a five-year oil and gas leasing program consisting of "a schedule of proposed lease sales indicating, as precisely as possible, the size, timing, and location of leasing activity which he determines will best meet national energy needs." 43 U.S.C. 1344(a). The Secretary is further required, "[d]uring the preparation of any proposed leasing program," to "invite and consider suggestions for such program from any interested Federal agency." 43 U.S.C. 1344(c)(1). That provision, which concerns the size, timing, and location of lease programs, has nothing to do with royalty valuation.

At bottom, petitioner misrepresents this case as one of misplaced deference by the court of appeals. Even assuming that there is a lack of judicial guidance in other (unidentified) settings, concerning questions of "overlapping regulatory programs," Pet. 21, there is no such overlap here, because there is no possibility that royalty valuation "may arise in another context before a different agency." *Ibid.* Accordingly,

this case plainly is not a proper vehicle for considering any such questions.[11]

2. Petitioner has not identified any error in the court of appeals' determination that the Department of the Interior "made a permissible interpretation of the federal regulations which govern royalties owing from federal natural gas leases." Pet. App. 2a. Petitioner does not challenge the court of appeals' affirmance of the Department's determination that its regulations require federal lessees to pay royalties on their gross proceeds, including reimbursements received from their purchasers under Section 110 of the NGPA. Petitioner's sole contention is that the court of appeals improperly accorded deference to the Department's interpretation of its regulations, because "DOI's decision leads to the anomalous result that the lower the quality of the gas (and therefore the more a producer must expend to improve its quality), the higher the royalty to which the government is entitled." Pet. 25.

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[11] Petitioner states that the court of appeals erred by (1) deferring to the Interior Department's construction of its royalty valuation regulations where the Department did not give FERC an "opportunity to provide its views" on the royalty valuation question, Pet. 22; or (2) in the alternative, by not obtaining FERC's views itself, Pet. 23. But petitioner raised neither of these arguments below—before the agency, the magistrate, the district court, or the court of appeals—and may not raise them for the first time in this Court. *DeShaney* v. *Winnebago County Dep't of Social Services*, 489 U.S. 189, 195 n.2 (1989). In any event, as we have explained in the text, FERC does not regulate royalty payments made by lessees to the federal government under the OCSLA, and the Interior Department's approach to the royalty question here is fully consistent with FERC's implementation of Section 110.

Petitioner's contention is erroneous for any of several reasons. First, even if royalty payments are higher on lower quality gas as a result of the marketable-condition and gross-proceeds rules, that result is no surprise to petitioner. Petitioner agreed in its leases with the government to the application of the Secretary's rules governing royalty valuation. Petitioner's leases and the regulations require petitioner to put gas produced under the federal leases into marketable condition, to pay royalties at a minimum based on the gross proceeds for the disposition of the gas, and to calculate royalties without deducting the costs of putting the gas into marketable condition. Those rules have been in effect for offshore leases since 1954. Indeed, until this case, petitioner and every other federal offshore lessee paid the government royalties based on the value of gas in marketable condition.[12] If the resulting royalties are "anomalous," that anomaly was reflected in the terms of the lease that petitioner voluntarily entered into with the government.

Moreover, the court of appeals correctly recognized that there is no anomaly of any legal significance here because, at bottom, the amount of royalties owed by a lessee to the federal government is based on the wholly unremarkable rule that the government re-

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[12] Petitioner erroneously asserts that it "regularly paid the DOI 16⅔ per cent of the amount which petitioner received from the disposition of the natural gas itself," but "did not pay royalties to the DOI on the Section 110 cost reimbursements." Pet. 5. Apart from the fact that petitioner paid royalties based on the value of the gas in marketable condition prior to enactment of the NGPA, petitioner also paid royalties on Section 110 reimbursements before challenging that royalty valuation in this case. See Pet. App. 7a n.20.

ceives more in royalties when the lessee receives more for the gas from the purchaser:

> [A]ny anomaly which results from allowing higher royalty on lower quality gas by assessing royalty on § 110 payments is a consequence of the NGPA/FERC price regulation system and not of the scheme setting out the royalty owner's rights. Indeed, this is a uniform result. The DOI-lessor simply obtains a flat percentage of all "gross proceeds" whether they be within the ceiling price or exceed it under § 110, obtaining more royalty where the lessee obtains a greater price, including cost reimbursements, from the pipeline purchaser.

Pet. App. 15a. The fact that a price regulation scheme may allow a lessee-seller to charge a purchaser more for what was initially lower quality gas does not alter or nullify established royalty valuation principles. If a purchaser is willing and permitted by law to pay more for certain marketable gas, the government receives a royalty share based on what the purchaser pays the lessee for that gas. And there is nothing remarkable about the facts that lower quality gas costs more to put into marketable condition or that the gas producer's overall profit margins may be lower on lower quality gas than on higher quality gas.

In short, there is nothing "absurd," Pet. 26, about the application of the royalty-valuation lease provisions and regulations to petitioner's Section 110 reimbursements, and there was no impropriety in the court of appeals' deference to the Department of the Interior's longstanding and reasonable construction of its own regulations in this case.

CONCLUSION

The petition for a writ of certorari should be denied.

Respectfully submitted.

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